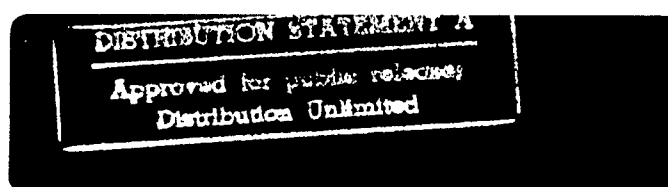


May 1996

CONTINGENCY OPERATIONS

DOD's Reported Costs Contain Significant Inaccuracies





United States
General Accounting Office
Washington, D.C. 20548

National Security and
International Affairs Division

B-271279

May 17, 1996

The Honorable Benjamin A. Gilman
Chairman, Committee on
International Relations
House of Representatives

The Honorable Floyd Spence
Chairman, Committee on
National Security
House of Representatives

As requested, this report discusses the reliability of the Department of Defense's (DOD) reported costs for contingency operations. We make recommendations that are designed to improve the reliability of reported costs. The information in this report should be useful to your committees in their deliberations on DOD's participation in contingency operations.

We are sending copies of this report to other interested congressional committees; the Secretaries of Defense, the Army, the Navy, and the Air Force; the Commandant, U.S. Marine Corps; and the Director, Office of Management and Budget. Copies will also be made available to others on request.

If you have any questions on this report, please call me on (202) 512-3504. Major contributors to this report are listed in appendix II.

Richard Davis
Director, National Security
Analysis

Contingency Operations:
DOD's Reported Costs
Contain Significant
Inaccuracies

DTIC QUALITY INSPECTED 4

Executive Summary

Purpose

Since fiscal year 1992, the Department of Defense (DOD) has reported over \$7 billion in incremental costs for its participation in contingency operations.¹ Accurate reporting of contingency operations costs is important for effective congressional oversight of appropriated funds. Over the past several years, the Congress has provided supplemental funding or reprogramming of previously appropriated funds to cover contingency operations costs. When costs are inaccurately reported, the Congress cannot assess with confidence the sufficiency of funds it has provided DOD.

In response to a request from the Chairmen of the House Committees on International Relations and National Security, GAO reviewed (1) the accuracy of DOD-reported incremental costs for contingency operations and (2) the adequacy of DOD guidance and accounting systems to ensure accurate cost reporting.

Background

The Secretary of Defense's 1995 Annual Report to the President and the Congress describes "contingency operations" as military operations that go beyond the routine deployment or stationing of U.S. forces abroad but fall short of large-scale theater warfare. During fiscal year 1995, U.S. military forces participated in a number of contingency operations. These operations included (1) support of U.N. peace operations in the former Yugoslavia, Haiti, and Southwest Asia; (2) increased deployment to South Korea in response to heightened tensions; (3) increased deployment to Kuwait and Saudi Arabia in response to the threat of renewed Iraqi aggression against Kuwait; and (4) the enforcement of a revised U.S. policy to prevent Cuban migrants from reaching the United States. DOD continues to be involved in contingency operations, including the operation in Bosnia involving implementation of the Dayton Peace Accords, which is estimated to cost \$2.5 billion.

Contingency operations such as these begin when the President decides to commit U.S. military forces to respond to developing world conditions that he judges affect U.S. interests. For new operations, DOD develops cost estimates before the actual deployment of military forces or early in the deployment. These estimates are commonly used as the basis for requested additional funds to cover operation costs. As the operation progresses, the incremental costs that are incurred are reported. Contingency cost reports consequently are important for monitoring the

¹As used in this report, "incremental costs" means those costs that would not have been incurred if it were not for the operation. This is the same definition contained in the Omnibus Budget and Reconciliation Act of 1990 (P.L. 101-508) and the fiscal year 1996 DOD Authorization Act.

adequacy of funding for such operations as well as for a variety of other purposes.

GAO has reported that when considering the cost of operations it should be recognized that DOD's financial systems cannot reliably determine costs.² Systems are classified as high risk, are not integrated, and cannot easily capture actual incremental costs. Only the total obligations are captured by the accounting systems. The services use various management information systems to identify incremental obligations and to estimate costs.

Results in Brief

GAO found inaccuracies in DOD's reported costs for contingency operations, representing about 7 percent of the \$4.1 billion in costs reported in fiscal years 1994 and 1995. In GAO's judgment, this variance in reported costs is indicative of a material weakness in the accounting systems. GAO identified about \$104 million in overstated costs and about \$171 million in understated costs. GAO also found that the accuracy of some reported costs could not be determined. It was not feasible to examine all reported costs and their supporting data, and GAO's results are not statistically projectable. Consequently, GAO is not able to conclude whether on balance the sum of reported incremental costs are overstated or understated.

DOD guidance for reporting incremental costs is vague and incomplete, and there are weaknesses in DOD's accounting systems. In February 1995, DOD added a chapter on contingency operations to its financial management regulations to include guidance for developing and reporting incremental costs. Neither DOD nor the resulting service guidance provides instructions on which costs to include, how to calculate them, or how to apply generally accepted internal control standards to test the accuracy and reliability of the reported costs. Finally, the incremental cost data is developed using financial management systems that DOD has reported as a high-risk area within its Federal Managers' Financial Integrity Act Statement of Assurance. The Office of Management and Budget (OMB) and GAO have also reported DOD's financial management as a high-risk area. DOD is taking steps to improve its incremental cost reporting, but problems in reporting accurate costs remain.

²Peace Operations: Information on U.S. and U.N. Activities (GAO/NSIAD-95-102BR, Feb. 13, 1995).

Principal Findings

DOD's Reported Incremental Costs Are Not Accurate

Some Costs Were Overstated

GAO identified about \$104 million in incremental costs that were overstated primarily because the services failed to adjust reported costs for normal operating and training costs that were not incurred. For example, GAO identified about \$11 million in reported normal operating costs at one Army command that were not actually incurred because the units were deployed to contingency operations.

The largest overstatement of reported costs GAO found, about \$70 million, occurred in the services' reported flying hour costs. The Air Force overstated its fiscal years 1994-95 incremental flying hour costs by \$67 million. For the most part, this was because the Air Force failed to adjust its reported fiscal year 1994 flying hour costs by the value of free fuel provided by other nations. The Navy overstated its incremental flying hour costs by \$3 million for the same reason.

Some Costs Were Understated

GAO also identified about \$171 million in incremental costs that were either not fully reported or not reported at all. The largest instance GAO found of underreporting involved military personnel costs. Although the Air Force reported some incremental personnel costs in fiscal year 1994, it did not report about \$81 million for such incremental costs as imminent danger pay and family separation pay. Air Force officials said they were unaware that they were required to account for and report all incremental military personnel costs. The Air Force accounted for and reported its incremental military personnel costs for contingency operations beginning in fiscal year 1995.

Other unreported costs for fiscal year 1995 include \$48 million for munitions the Navy used in the former Yugoslavia and about \$28 million in incremental costs related to Air Force mobility equipment and munitions.

Accuracy of Some Costs Could Not Be Determined

The services cannot readily extract from their pay system the incremental costs related to special pays and allowances for contingency operations. With the exception of the U.S. Marine Corps, the payroll and personnel systems are not linked to provide these incremental personnel costs.

Consequently, the services generally estimate them. For example, the Army applies estimated cost factors to the estimated number of personnel deployed to determine incremental personnel costs. DOD has plans underway to link the payroll and personnel systems, which will provide more accurate incremental personnel contingency costs.

The Army and the Air Force have reported the amounts they paid for transporting personnel and equipment for contingency operations. Both services, however, questioned the validity of the bills received from DOD agencies that were the basis for these payments. The Army identified \$11 million in fiscal year 1995 transportation charges it believed to be invalid for airlift, sealift, and port handling. It identified problems such as duplicate charges, unidentified customers, and missing data, which prevented identifying the appropriate charges. Air Force officials also have similar concerns about the accuracy of their transportation bills.

Factors Contributing to Inaccuracies in Cost Reporting

Vague and Incomplete Guidance

While DOD's revised February 1995 guidance provides some instruction to DOD components to identify incremental costs and determine offsets, the guidance is general and incomplete. For example, it excludes discussion of offsetting certain costs that are not incurred as a result of contingency operations and other savings that occur during participation in such operations, such as supply turn-ins. Ultimately, the guidance directs the DOD components to determine incremental costs. However, the services have not developed comprehensive implementing instructions that address how to identify, calculate, and adjust the incremental costs and how to apply internal control standards to the reported incremental costs.

As stated in the February 1995 guidance, DOD policy requires that controls and procedures provide proper identification and recording of costs incurred in supporting contingency operations in financial records. In addition, the guidance delegates the responsibility to the services to report costs accurately. DOD guidance is vague on applying internal control standards to test the accuracy and completeness of reported incremental costs.

**Weaknesses in DOD
Accounting Systems**

The problems GAO has identified in the reporting of contingency operations costs reflect, in part, the broader problems with DOD's accounting systems. DOD's 1994 and 1995 Federal Managers' Financial Integrity Act Statement of Assurance admit long-standing weaknesses in DOD's accounting systems and state that none of DOD's operating accounting systems comply with appropriate accounting standards and related requirements. Accordingly, DOD financial management systems are classified as high risk by OMB. In a November 1995 testimony, GAO stated that no military service or major DOD component has been able to withstand the scrutiny of an independent financial statement audit, a requirement established by the Chief Financial Officers Act. GAO's review of the Navy's financial reports, the Army Audit Agency's review of the Army's financial statements, and the Air Force Audit Agency's review of the Air Force's financial statements identified significant accounting and reporting problems resulting in unauditible financial statements and reports for fiscal year 1994. DOD also has no cost accounting system and has directed that contingency cost reporting use existing systems, so it must develop its contingency cost reports within the limitations of its existing systems.

Recommendations

GAO is making two recommendations to the Secretary of Defense to improve the accuracy of contingency operation cost reporting.

**Agency Comments
and GAO's Evaluation**

DOD generally concurred with a draft of this report. It agreed with GAO's recommendations and said that it will attempt to clarify existing guidance. DOD's comments appear in appendix I.

Contents

Executive Summary		2
Chapter 1		10
Background	DOD Reports Incremental Costs of Contingency Operations	10
	DOD Often Seeks Supplemental Funding for Contingency Operations	11
	DOD's Cost Reports Are Important	13
	Methodology for Developing Cost Reports	14
	Objectives, Scope, and Methodology	15
Chapter 2		17
Reported Contingency	Costs Are Overstated Because They Are Not Adjusted to Reflect Offsets	17
Costs Contain	Some Contingency Operation Costs Were Incurred but Not Reported	22
Significant	Accuracy of Some Other Costs Could Not Be Determined	24
Inaccuracies	Conclusions	26
Chapter 3		27
Guidance for	DOD and Service Guidance for Reporting Incremental Costs Is Vague	27
Reporting Incremental	Weaknesses Exist in DOD Accounting Systems Used to Provide Data	30
Costs Is Vague and	Recommendations	32
Accounting Systems	Agency Comments and Our Evaluation	32
Are Unreliable		
Appendixes	Appendix I: Comments From the Department of Defense	34
	Appendix II: Major Contributors to This Report	36
Tables	Table 1.1: Incremental Cost of Contingency Operations	11
	Table 2.1: Overstated and Understated Contingency Costs by Appropriation Account	17
	Table 2.2: Air Force's Reported and Estimated Fiscal Year 1994 Incremental Personnel Costs	23

Contents

Abbreviations

DOD	Department of Defense
FMFIA	Federal Managers' Financial Integrity Act
IG	Inspector General
OMB	Office of Management and Budget
OSD	Office of the Secretary of Defense

Background

The United States has participated in a number of contingency operations since the end of the Persian Gulf War. The Department of Defense (DOD) describes contingency operations as military operations that go beyond the routine deployment or stationing of U.S. forces abroad but fall short of large-scale theater warfare. They include smaller-scale combat operations, peace operations, and other missions, such as humanitarian assistance. Contingency operations involving U.S. military forces have included (1) operations in support of U.N. peace operations in the former Yugoslavia, Haiti, Somalia, and Southwest Asia; (2) increased deployment of military capability to Southwest Asia and South Korea in response to heightened tensions; and (3) other key missions, including humanitarian and refugee assistance, such as support for Rwandan refugees.

DOD Reports Incremental Costs of Contingency Operations

Two broad cost categories are associated with contingency operations—incremental and total. DOD reports the incremental costs of its participation in contingency operations. As used in this report, “incremental costs” means those costs that would not have been incurred except for the operation. This is the same definition contained in the Omnibus Budget and Reconciliation Act of 1990 (P.L. 101-508) as well as in the fiscal year 1996 DOD Authorization Act. Examples of incremental costs are (1) special payments to participating military personnel, such as imminent danger pay; (2) transportation costs to deploy personnel to the area of operations; (3) contractor support for deployed forces; and (4) reconstitution of equipment used in the operation.

In addition to incremental costs, DOD incurs costs to maintain a standing military force. These costs include (1) basic military pay; (2) fuel, spare parts, and maintenance to train and sustain military forces; and (3) procurement of military equipment, such as aircraft, ships, and tanks. These costs would be incurred regardless of whether military forces deployed to a contingency operation or remained at their home station, and they are not to be included in contingency cost reporting.

The costs to participate in contingency operations have been substantial. Since fiscal year 1992, DOD has reported more than \$7 billion in incremental costs. Table 1.1 provides detail on the reported incremental costs.

**Table 1.1: Incremental Cost of
Contingency Operations (Fiscal Years
1992-95)**

Dollars in millions	
Country/region	Reported costs
Former Yugoslavia	\$784
Haiti	953
Cuba	372
Rwanda	144
Somalia	1,522
Southwest Asia	2,234
All others	1,138
Total	\$7,147

Source: DOD Comptroller.

DOD Often Seeks Supplemental Funding for Contingency Operations

Through fiscal year 1996, DOD has not budgeted for the cost of military operations or contingencies.¹ It has budgeted to be ready to conduct such operations. When the services have had to conduct contingency operations, they initially have had to shift funds within existing appropriations. This is done primarily by using funds appropriated for the same purpose but scheduled for obligation later in the fiscal year. Subsequently, DOD has often sought supplemental funding or reprogramming of appropriated funds to cover its costs.

In fiscal year 1993, to pay for the cost of operations in Somalia, DOD asked for and received a supplemental appropriation that also rescinded \$750 million from other areas within its budget. Congress provided no new funds. In fiscal year 1994, DOD received two supplementals to fund ongoing contingency operations: one for \$1.2 billion in February 1994 and one for \$299 million in September 1994. The February 1994 supplemental was funded with a mix of new budget authority and rescission of existing authority. The September 1994 supplemental provided funding through the Defense Emergency Relief Fund, which was designed to reimburse other appropriation accounts for costs incurred in responding to emergencies. In fiscal year 1995, DOD received a supplemental appropriation that included \$2.2 billion intended for contingency operations. This supplemental also contained a mix of new budget authority and rescissions. For fiscal year 1996, the administration is seeking \$620 million in supplemental funding and the reprogramming of \$991 million in previously appropriated funds for DOD's incremental costs associated with

¹The Air Force has included funds in its budget request for the military personnel appropriation account for the payroll cost of reserve volunteers participating in contingency operations.

the deployment of U.S. forces to implement the Bosnia peace agreement. The administration proposes to fully offset the supplemental with a corresponding rescission.

Cost Estimates Tend to Increase

DOD's estimate of supplemental funding needs is based on cost estimates developed before or during the operation. Developing the estimate involves (1) making assumptions about a number of factors, including the number of military personnel needed to conduct the operation, its expected duration, and the logistical requirements to support operations and (2) costing out the assumed force, using standard cost factors that are in turn based on historical costs and, where there are no cost factors, military judgment. For existing operations, DOD projects costs based on costs incurred in the previous year unless it expects an operation to change in size, scope, or duration. The estimate of required supplemental funding is prepared and reviewed within DOD and then reviewed by the Office of Management and Budget (OMB). The reviews can result in some parts of the request being deleted and other costs being added to the request. Overall, the cost estimates tend to increase as the estimates move through the review process.

Within DOD, the Office of the Secretary of Defense (OSD) Comptroller reviews service submissions and prepares a program budget decision that serves as the basis for senior level DOD review. In the last 2 years, the estimates we have reviewed have tended to increase during final review within DOD and OMB. For example, in developing the cost estimate for fiscal year 1995 contingency operations, the overall estimate increased by \$104 million. Within this amount, the OSD Comptroller reduced proposed funding for part of one operation, Cuba migrant operations, by \$3 million and increased funding by \$107 million for several other operations, including operations in Haiti. DOD's estimated costs as expressed in the approved program budget decision are also reviewed within OMB when the administration seeks supplemental funding. OMB, for example, increased the estimate of required fiscal year 1995 funding by \$126 million over the amount proposed by DOD. OMB increased many of the estimates for required funding to support contingency operations. The biggest single increase was for operations in Cuba—an increase of \$16 million to cover additional operating and maintenance costs and personnel costs.

In developing the cost estimate for operations in and around Bosnia for fiscal years 1996 and 1997, the estimated cost increased by \$164 million between the preliminary program budget decision and the final one

submitted to the Deputy Secretary of Defense. Within the total increase, some estimated costs increased while others decreased. For example, the estimate for support costs for personnel in Bosnia decreased by \$20 million, and the estimate for contractor support increased by \$32 million. In approving the final decision document, the Deputy Secretary added \$96 million to the amount proposed in the final program budget decision to reflect December 1995 special pay for military personnel deployed in and around Bosnia and command and control augmentation initiatives, which had not been included in the estimate submitted to him. In developing the plan for financing the operation, DOD further increased the estimated cost by almost \$82 million.

Reported Costs Vary From Estimates

Actual costs can vary from the estimate as changes occur to the operation. For example, DOD originally estimated that Vigilant Warrior, the deployment of military forces to Southwest Asia in response to Iraqi troop movements, would cost \$462 million in fiscal year 1995. However, the operation ended in December 1994 and cost only \$258 million. This was about \$204 million below the estimate because the operation concluded sooner than expected as the Iraqis pulled their troops back. On the other hand, DOD estimated that the operation in Haiti would cost \$465 million in fiscal year 1995, but through the end of fiscal year 1995, DOD had reported costs of \$569 million. This was in part due to unforeseen requirements associated with Operation Uphold Democracy and U.N. effort.

DOD's Cost Reports Are Important

As previously mentioned, DOD has reported more than \$7 billion in incremental costs for its participation in contingency operations since the end of the Gulf War. The number, size, and scope of these operations have increased over the past several years as the United States has responded to events in a number of locations, including Somalia, Haiti, Bosnia, Rwanda, and Iraq. The U.S. participation in implementing the Dayton Peace Accords, including deploying over 18,000 troops to Bosnia-Herzegovina, which began in December 1995, and the April 1996 evacuation of American civilians from Liberia are the latest examples of the kinds of operations in which the United States has become engaged. Contingency operations such as these begin when the President decides to commit U.S. military forces to respond to developing world conditions that he judges affect U.S. interests. For new operations, DOD develops cost estimates before the actual deployment of military forces or early in the deployment. These estimates are commonly used as the basis for

requested additional funds to cover operation costs. As the operation progresses, the incremental costs that are incurred are reported.

Contingency cost reports consequently are important for monitoring the adequacy of funding for such operations as well as for a variety of other purposes. They help DOD monitor the resources necessary to support contingency operations, which enables DOD to determine the implications for readiness when drawing from previously appropriated operation and maintenance funds to cover contingency costs. They also aid DOD in developing requests for supplemental appropriations and reprogrammings. DOD uses them to respond to congressional and public interest about the incremental cost of specific operations as well as all contingency operations. Also, they facilitate congressional oversight of the expenditure of appropriated funds and the assessment of the financial impact of contingency operations on DOD's spending plans.

Cost reporting is also important for reimbursement. DOD's financial management regulation for contingency operations discusses proper identification and reporting of costs to support billings. This is important in instances where the United States is due reimbursement from the United Nations and for the distribution of reimbursements to applicable organizations.

Methodology for Developing Cost Reports

DOD financial guidance requires that the services use existing systems to record their costs of contingency operations. The services record costs as they are incurred during the course of the mission. Therefore, unlike the estimates of costs developed before and during the mission, cost reporting is historical in nature.

Some costs are initially recorded by the military unit that incurs the cost. For example, personnel in an Army unit that purchases spare parts to prepare equipment for deployment record the purchase against the financial management code assigned for the operation. Individual costs are consolidated at Army headquarters from the Army's financial management system. Other costs are determined centrally. For example, Air Force units report their flying hours, but Air Force headquarters translates those flying hours into costs. DOD consolidates the services reports and publishes a monthly contingency cost report.

Objectives, Scope, and Methodology

In response to a request from the Chairmen of the House Committees on International Relations and National Security, we reviewed (1) the accuracy of DOD's reported incremental costs for contingency operations and (2) the adequacy of DOD guidance and accounting systems to ensure accurate cost reporting.

To review the accuracy of reported costs, we examined the methodology for reporting incremental costs and contingency operation cost reports for fiscal years 1994 and 1995 throughout DOD. We used auditor's judgment as prescribed by the American Institute of Certified Public Accountants to determine the materiality of reporting inaccuracies. We conducted our work at the OSD (Comptroller); all service headquarters; and major commands within each service that were heavily involved in determining incremental costs, including the U.S. Army Forces Command and U.S. Army, Europe, the Air Force's Air Combat Command, Air Mobility Command, and U.S. Air Forces in Europe, the Navy's Commanders in Chief, Atlantic and Pacific Fleet, the Commander, Marine Forces Atlantic, and the U.S. Transportation Command. We also conducted work at individual military units that participated in contingency operations in fiscal years 1994 and 1995. Individual units visited included the XVIII Airborne Corps in Fort Bragg, North Carolina; 101st Air Assault Division in Fort Campbell, Kentucky; 25th Infantry Division in Schofield Barracks, Hawaii; 48th Fighter Wing in Lakenheath, England; 1st Fighter Wing in Langley, Virginia; and the II Marine Expeditionary Force in Camp LeJeune, North Carolina. At the locations we visited we discussed how the incremental costs of contingency operations are captured and reviewed costs reported at that location. We also examined the guidance that the locations had received from higher command levels regarding contingency cost reporting and the views of cognizant officials at those locations regarding the adequacy of the available guidance.

To assess the adequacy of DOD's accounting systems and internal controls, we drew from our past work and the work of the DOD Inspector General (IG) and the military audit agencies on the financial audits required under the Chief Financial Officers Act. We also examined DOD's annual Federal Managers' Financial Integrity Act (FMFIA) Statement of Assurance, which detail the significant internal control problems of DOD and the military services. We consulted with DOD's IG and the military audit agencies regarding planned work to assess the extent of audits of contingency cost reporting. We discussed the extent to which cost reports are reviewed for accuracy at locations visited.

We conducted our review between May and December 1995 in accordance with generally accepted government auditing standards.

Reported Contingency Costs Contain Significant Inaccuracies

In fiscal years 1994 and 1995, we found inaccuracies in DOD's reported contingency operation costs that represented about 7 percent of reported incremental costs. The American Institute of Certified Public Accountants states that a financial auditor must consider materiality in the scope of work to be performed and leaves the threshold of what constitutes a material weakness to the auditor's judgment. In our judgment, a 7 percent known error as well as potential errors in the unauditable amounts discussed below, constitutes a material weakness in the accounting systems. A material weakness raises questions about the reliability of reported costs. DOD reported incremental costs of about \$4.1 billion for contingency operations that occurred in fiscal years 1994 and 1995. We identified about \$104 million in overstated costs and about \$171 million in understated costs between fiscal years 1994 and 1995. Table 2.1 summarizes these over- and understatements by appropriation. We also found instances where the accuracy of some reported costs could not be determined. It was not feasible to examine all reported cost data, and our results are not statistically projectable. Consequently, we are not able to conclude whether on balance the sum of reported incremental costs are overstated or understated.

Table 2.1: Overstated and Understated Contingency Costs by Appropriation Account (Fiscal Years 1994-95)

Dollars in millions		
Appropriation account	Overstated costs	Understated costs
Operation and Maintenance	\$104	\$14
Military Personnel	0	81
Procurement	0	76
Total	\$104	\$171

Costs Are Overstated Because They Are Not Adjusted to Reflect Offsets

The services do not have financial management systems that capture actual incremental costs. Therefore, the services use various financial management systems to identify obligations and modify them to arrive at their incremental costs. In addition, with the exception of the Army, the services receive input from their subordinate commands. As required by DOD guidance, the services are then to offset their incremental costs by those costs for which funds were appropriated, but not spent because of participation in the contingency operation. For example, reported costs should be adjusted for such functions as training not conducted and base operations not provided. However, we found that this was not always being done.

**Reported Cost Not
Adjusted for Normal
Operating Costs Saved**

We found instances where reported incremental costs were not offset by normal operating costs, such as base operations, that were saved due to participation in contingency operations. For example, Army Headquarters did not apply these offsets when calculating its incremental costs. In fiscal year 1995, the U.S. Army Forces Command, which was responsible for supporting most of the Army forces involved in contingency operations in that year, estimated that military units did not incur about \$11 million in funded normal operating costs as a result of deploying to contingency operations. Therefore, these funds were recoverable. For example, U.S. Army Forces Command estimated that Fort Drum, home of the 10th Mountain Division (Light), had not incurred almost \$3 million in base operations cost because a large part of the division was deployed to Haiti and so was not incurring some normal day-to-day costs. Although Forces Command officials made this information available to senior command officials, no action was taken to offset reported costs.

In another instance, the 25th Infantry Division (Light), part of the U.S. Army, Pacific saved \$1 million from normal operating costs while part of the division was deployed to Haiti because its operating costs during deployment were paid by another Army command. Thus, the division was able to use the \$1 million it saved from normal operating costs not incurred to acquire equipment it could not otherwise afford within its annual budget. Neither the division nor higher command levels in the Army adjusted these reported contingency costs to reflect these savings. The Army chose to allow units that had savings to retain and use them for otherwise unfunded needs.

In fiscal year 1996, at least one major command, U.S. Army, Europe, has identified offsets and adjusted its funding estimate accordingly. U.S. Army, Europe, which has the lead responsibility for tracking U.S. Army costs resulting from participation in implementing the Dayton Peace Accords in Bosnia, anticipates that it will not incur about \$113 million in fiscal year 1996 normal operating costs as a result of its participation in Bosnia. In reporting fiscal year 1996 costs, the Army should offset its incremental costs by this amount.

**Reported Costs Not
Adjusted for Training Not
Conducted**

We identified two cases where the services did not adjust reported costs to offset training not conducted due to participation in contingency operations. In fiscal year 1995, the Army's 25th Infantry Division (Light) reported about \$2 million in costs associated with deploying to Haiti. The division was scheduled to participate in a training exercise at the Joint

Readiness Training Center. U.S. Army, Pacific, the command that funds the division, had budgeted more than \$6 million for the cost of this exercise. Because elements of the division's brigades were deployed to Haiti, the division did not participate in this exercise. The 25th Infantry Division's (Light) cost to participate in the Haiti operation was not adjusted to reflect the savings from the missed training exercise. The Department of the Army directed the U.S. Army, Pacific to use \$2 million of the \$6 million to fund other Army requirements and allowed the command to retain the remaining \$4 million, which it used to cover all of the 25th Infantry Division's (Light) \$2 million cost associated with Haiti and to meet otherwise unfunded needs. Consequently, we believe that the division's \$2 million in incremental costs were fully offset by the training costs that were not incurred and there were no incremental costs.

Another example of reported incremental costs not offset by training not conducted was found in the Air Force. In fiscal year 1994, the 48th Fighter Wing had to cancel its participation in several training exercises because of contingency operations. U.S. Air Forces, Europe budgeted \$1 million for this training. Although the training was canceled, the command made no adjustment to its reported incremental costs.

In these examples, neither the Army nor the Air Force adjusted its reported costs to reflect the savings from canceled training. For the Army, this was because Army headquarters did not apply any offsets, including those related to canceled training, to its reported costs for fiscal year 1995. The Air Force example was due to U.S. Air Forces, Europe not offsetting its reported costs that were forwarded to Air Force headquarters, who prepared the final cost report.

Flying Hour Costs Not Adjusted for Actual Costs and Value of Free Fuel

We found instances where the services overstated flying hour costs. For example, the Air Force overstated fiscal years 1994 and 1995 incremental flying hour costs by \$67 million. The reasons for the overstatement were that it (1) did not use actual cost factors to report costs in fiscal years 1994 and 1995 and (2) did not offset its flying hour costs by the value of free fuel received from the Kingdom of Saudi Arabia in fiscal year 1994.

According to Air Force officials, the Air Force calculated its incremental flying hour costs by applying budgeted cost factors for supplies, repair parts, maintenance, and fuel to the additional hours flown per aircraft above budgeted flying hours. These cost factors reflect the average historical costs, by aircraft type, to operate, not their actual costs. In fiscal

year 1994, we determined that U.S. Air Forces, Europe actual costs of contingency flying hours were about \$19 million below that funded by the Air Force.

According to command officials, when actual costs are lower than the budgeted factors for an aircraft, the command is allowed to retain the excess. Conversely, when costs are above these factors, the command must absorb the increased cost within its budget. For example, we calculated that Air Combat Command had to absorb \$4 million for fiscal year 1994 because its actual costs were higher than the budgeted factors. In the same year, Saudi Arabia provided the Air Force free fuel valued at \$45 million to support contingency operations in Southwest Asia. The Air Force failed to deduct the value of this free fuel when computing its incremental flying hour costs for Operation Southern Watch, thereby overstating its costs.

In fiscal year 1995, the Air Force headquarters revised its methodology for calculating incremental flying hour costs to reflect the receipt of free fuel. However, it continued to compute the flying hour costs by using the budgeted versus actual cost factors. Consequently, Air Force headquarters computed almost \$74 million for Air Combat Command's incremental flying hour costs, while the command's actual costs were about \$7 million lower because actual costs were less than the budgeted cost factors. We did not have comparable data to calculate U.S. Air Forces, Europe's costs.

We also found that the Navy used either budgeted or actual cost factors when determining its incremental flying hour cost. The Navy Atlantic Fleet used budgeted rates reflecting average historical cost applied to its additional flying hours, while the Pacific Fleet applied actual rates for the most part when determining its costs. The Navy Pacific Fleet provided an example where the actual rates were higher than the budgeted costs allowed for fiscal year 1995. For its F/A-18A, F/A-18C, and P-3C aircraft involved in contingencies, the actual costs per hour for these aircraft were higher than the budgeted costs by \$2,632, \$126, and \$41, respectively.

Furthermore, Navy officials also stated that the Navy's fiscal year 1994 and 1995 flying costs were not adjusted for free aviation fuel. In fiscal year 1994, the Navy reported almost \$6 million for aviation fuel used in Operation Southern Watch but did not adjust this amount by the \$2 million of free fuel received. Therefore, the Navy overstated its reported costs by 33 percent. Similarly, in fiscal year 1995, the Navy did not adjust its reported costs to reflect \$1 million of free fuel received for operations in

Southwest Asia. Navy headquarter officials stated that the value of free fuel received for operations was accounted for in its flying hour costs factors, which were used to determine flying hour costs. However, the Navy did not provide documentation to support its position.

**Reported Costs Not
Adjusted to Reflect Unused
Items or Credits From
Items Returned to the
Supply System**

The value of items that have been purchased for contingency operations but not used and either retained by the unit or returned to the DOD supply system for credit is not deducted from reported incremental costs. For example, the U.S. Army, Europe purchased parachutes and rigging supplies to support the airdrop mission over Bosnia during 1994. The cost of this material, over \$23 million, was reported as an incremental cost of that contingency operation. In July of 1994, the Army Audit Agency found that \$12 million of this equipment was excess to the command's needs and recommended that the command turn in the supplies to receive a credit. However, U.S. Army, Europe officials did not concur with this recommendation and retained the material. They believed that the equipment was necessary for immediate future contingency airdrop operations. Also, they did not want to turn in the inventory because they believed that it made little sense to turn in equipment, receive a limited credit for it, and then buy it back at full price for anticipated operations. Regardless of whether the material was returned, the reported incremental cost should have been adjusted by the \$12 million of material not used in the contingency operation. However, neither the command nor Army headquarters adjusted the reported cost.

In fiscal year 1995, the Army's 101st Airborne Division was told that it would deploy to a contingency operation in Southwest Asia. Although the Division incurred some costs to prepare to deploy, it ultimately did not deploy. However, it reported incremental predeployment costs of \$14 million. The reported costs were not adjusted by Army headquarters to offset the value of items not used. Division officials estimated that about \$7 million or more of the reported costs were incremental, the balance was eventually used for normal operating costs.

When items that are purchased for use in a contingency are ultimately not used and are returned to the supply system, they are credited to a general operation and maintenance fund, but the reported incremental costs of the contingency are not reduced. According to Army officials, there is no system in place to ascertain which of the supplies turned in were originally purchased for a contingency operation. In addition, the DOD guidance on reporting contingency costs does not specifically require the services to

turn in these items as a means to credit the reported costs of the contingency operation or adjust reported costs to reflect the value of items purchased for contingency operations but not used in them.

**Military Pay Costs for
Reservists Not Adjusted to
Reflect Base Pay**

The reported incremental military personnel costs for reservists volunteering for or called to active duty are not adjusted to reflect regular monthly reserve pay that is not being incurred. When federalized, reservists receive active duty base pay plus allowances, and special pays, some of which are based on where they are deployed. According to Army and Air Force officials, they do not adjust reported incremental military pay for reservists on active duty in contingencies by the monthly reserve pay they would have received had they not been activated. We believe that because these are costs that are not incurred as a result of contingency operations, the incremental personnel costs should be offset by these amounts. We did not determine the amount of this overstatement.

**Some Contingency
Operation Costs Were
Incurred but Not
Reported**

We found instances where services did not report certain incremental contingency costs. The unreported costs included military personnel pay, aviation parts, and procurement.

**Military Personnel Costs
Not Reported by Air Force**

Military personnel who deploy to contingency operations become eligible for special pay and allowances such as imminent danger pay, certain places pay (formerly known as foreign duty pay), and family separation pay. We found that the Air Force did not report about \$81 million of the almost \$100 million it estimated as incremental personnel costs for fiscal year 1994. According to Air Force officials, they were not aware that they were required to track and report these costs. Table 2.2 compares the Air Force's reported incremental personnel costs for fiscal year 1994 with the estimated costs that should have been reported.

Chapter 2
Reported Contingency Costs Contain
Significant Inaccuracies

Table 2.2: Air Force's Reported and Estimated Fiscal Year 1994 Incremental Personnel Costs

Dollars in millions			
Operation	Reported costs	Estimated costs	Difference
Bosnia	\$7.6	\$66.5	\$(58.9)
Cuba/Haiti	0.0	1.1	(1.1)
Rwanda	0.4	0.0	0.4
Somalia	0.4	4.3	(3.9)
Southwest Asia	10.4	27.8	(17.4)
Total	\$18.8	\$99.7	\$(80.9)

Source: Developed by GAO using Air Force data.

Air Force headquarters officials said that, in fiscal year 1994, they reported the amount of supplemental funding received for military personnel as their military personnel incremental costs. However, beginning in fiscal year 1995, the Air Force tracked and reported these costs.

Cost of Aviation Parts Not Reported

We found one instance where an Air Force command did not report the value of aviation spare parts used in contingency operations at one of its bases. The cost was instead recorded in the base's account for normal operations. According to a 1st Fighter Wing official, if parts are not available to support deployed aircraft during contingency operations they are removed or cannibalized from base aircraft and replaced when needed parts are received. Between May 1994 and October 1995, the command's 1st Fighter Wing estimated that it had used approximately \$10 million in spare parts to support operations in Southwest Asia. However, the Wing official stated that this cost was charged to the base maintenance account when replacement parts were cannibalized for contingency operations rather than reported as contingency cost because in their view the base accounting system only allows one account for maintenance. Thus, the contingency-related maintenance costs were commingled with normal base maintenance costs.

Replacement Costs for Equipment Not Reported

We found that the Air Force did not report \$12 million to replace mobility equipment (tents, field kitchens, water systems, and warehouse and maintenance facilities) that were reported as lost during contingency operations in fiscal year 1995. An Air Force official stated that replacement costs for these items were not considered incremental costs because funding for these items was requested through the budget process and

additional expenses were not incurred. However, we believe that these replacement costs should have been reported as incremental costs because the equipment was used in support of contingency operations and in all likelihood would not have been rendered unusable or destroyed were it not for the operation.

Munitions Cost Not Reported

The Navy and the Air Force are not tracking and reporting the cost of munitions used in contingency operations. During the 1995 bombing campaign in Bosnia, the two services consumed almost \$64 million worth of munitions—\$48 million for the Navy and \$16 million for the Air Force. According to an Air Force official, Air Force munitions were not drawn from excess stock levels. A Navy official said that Navy munitions will have to be replaced.

DOD officials told us that services are not reporting the costs of munitions consumed in contingency operations because they absorbed munitions procurement costs in normal budgets and do not consider the value of munitions consumed in contingencies to be incremental costs. However, since these are costs that would not have been incurred were it not for the operation, we believe that they should be included in reported costs.

Accuracy of Some Other Costs Could Not Be Determined

The accuracy of reported costs could not be determined for some cost categories relating to active and reserve military personnel and transporting personnel and equipment.

Services Report Estimated Incremental Personnel Costs

Military personnel deployed to contingency operations become eligible for several types of special pays and allowances. These can include imminent danger pay, certain places pay, and family separation pay. These types of special pays and allowances would not be paid were it not for the contingency operation, so they are considered incremental costs. Because the military services cannot readily extract the amount of the special pays and allowances from their military pay system, they estimate the incremental pay costs. This makes it difficult to ascertain the accuracy of these costs, which may be over- or understated. In addition, the military services do not all use the same estimating methodology.

In fiscal year 1995, the Air Force applied estimated cost factors to the actual number of deployed active military personnel to derive special pays and allowances. The Army and the Marine Corps also applied estimated

cost factors but instead used the estimated number of deployed active personnel. The Navy, on the other hand, reports actual costs from its military pay center but only included imminent danger pay. This is because the nature of the Navy's normal deployment schedules already include special pays and allowances, such as family separation pay. Therefore, those pays are not characterized by the Navy as incremental.

Officials from the other services told us that they do not reconcile reported incremental personnel costs to actual payroll cost reports to determine the accuracy of their reported estimated contingency figures. Although the services' payroll systems calculate how much the personnel deployed should receive in special pays and allowances and are able to distinguish between geographic locations, they are not configured to distinguish between contingency operations and other deployments. On the other hand, the personnel systems are capable of determining who is deployed and the location of this deployment. However, the payroll and personnel systems are not configured or linked to provide the incremental contingency costs.

DOD has plans underway to link the payroll and personnel systems. On the basis of discussions with Defense Finance Accounting System officials (who operate the military payroll system) and OSD officials in the military personnel arena, we believe that linking the payroll and personnel systems to allow the extraction of actual special pay and allowance costs may only involve providing one additional space in computer records to allow for a code indicating that a service person is deployed to a contingency operation. Until the two systems are linked it is not possible to test the accuracy of estimated costs.

The services also use estimates rather than actual data to derive incremental personnel costs for reservists on active duty in contingency operations. The Air Force and the Army multiply actual numbers of reservists participating in contingency operations by estimated base salary as well as by the special pays and allowances. According to Navy officials, the Navy did not report any incremental personnel costs for the number of reservists who supported contingency operations in fiscal years 1994 and 1995.

**Reported Costs Include
Disputed Transportation
Bills**

Although paid and reported as incremental contingency costs, the Army and the Air Force question some of their bills to transport personnel and equipment for contingency operations, which may have resulted in

overstated costs. Allowable transportation costs include moving personnel, material, equipment, and supplies to the contingency area. The services pay the Military Traffic Management Command for port handling, the Military Sealift Command for sealift, and the Air Mobility Command for airlift. If billing errors exist, reported incremental transportation costs are also inaccurate.

The U.S. Army Forces Command identified \$11 million in transportation charges it believed to be invalid for airlift, sealift, and port handling services in fiscal year 1995. This represented 16 percent of the command's total contingency transportation charges for that year. In the review of bills, command officials found problems such as unidentified customers, duplicate charges, and missing data that prevented the validation of charges. For example, officials estimated that over 50 percent of fiscal year 1995 contingency port handling bills had disputed charges. The command requested transportation providers to respond to disputed charges; however, responses have been minimal and few credits applied.

Air Force officials also told us that they have noticed problems with transportation bills but do not have the resources to research and validate the bills. In fiscal year 1995, the Air Combat Command incurred \$17 million in airlift contingency charges. Command officials believe that the airlift bills may include errors and reported incremental costs may be inaccurate. For example, command officials told us that some of their bills may include other services' airlift mission charges.

Conclusions

We found a number of inaccuracies in DOD's fiscal years 1994 and 1995 reported incremental costs, which resulted in costs being overstated, understated, or unable to be determined. In our opinion the magnitude of these inaccuracies is material to the reported costs. With regard to incremental military pay costs, we believe DOD's plan to link the military pay and military personnel systems will be helpful in capturing actual military pay incremental costs.

Guidance for Reporting Incremental Costs Is Vague and Accounting Systems Are Unreliable

The DOD Comptroller and the service secretaries have not developed sufficiently specific guidance for identifying contingency operation costs and the methodology for calculating them. DOD and the services also have not taken steps to ensure that cost development methodologies are consistent and that key officials involved in accounting for incremental cost reporting are made aware of guidance. In addition, DOD and the services have not adequately ensured that cost reports are complete, accurate, timely, and appropriately reviewed. This would include that costs are properly recorded and classified and supporting documentation is maintained. Further, DOD accounting systems are classified as high risk and cannot reliably determine incremental costs.

DOD and Service Guidance for Reporting Incremental Costs Is Vague

In February 1995, DOD added a chapter on contingency operations to its financial management regulations. Prior to the addition of this chapter, contingency cost guidance consisted of a patchwork of messages and directives issued during and since the Gulf War. The new chapter directs the services to provide monthly incremental cost reports in accordance with DOD policy and makes the services responsible for accurate cost reporting. The chapter also

- requires that controls, accounting systems, and procedures identify and record costs incurred in support of contingency operations;
- directs that the services use the project code established for an operation;
- makes service Comptrollers responsible for determining incremental costs;
- sets out cost reporting requirements;
- provides broad guidelines for determining costs; and
- requires that reported costs be adjusted for offsets.

DOD guidance is vague about what costs to include as contingency costs and what methodology to use in calculating these costs. Because DOD's guidance is vague, the services and some commands within the same service calculate costs differently. The guidance is also vague on applying internal controls standards to test the accuracy and completeness of reported costs. Several service officials at the reporting level stated that more specific guidance was needed. DOD officials stated that they are willing to clarify the guidance to the services if this will assist them in their cost reporting.

To date, Army guidance has consisted of a series of messages regarding reporting procedures for specific contingency operations, funding

responsibilities, and reimbursement from the United Nations. The guidance also notes broad cost categories but does not contain specific guidance as to what costs to report and how to calculate them. The Army has since drafted some implementing guidance that discusses how to calculate offsets and requires major commands to certify costs, but as of April 1996, this guidance had not been approved. Air Force guidance has been limited to describing reporting formats and deadlines. Neither the Navy nor the Marine Corps has developed any formal instructions to guide their subordinate commands. They have relied, for the most part, on oral instructions and electronic mail messages, which have also been limited to reporting procedures.

**Guidance Is Not Specific
About What Costs to
Include**

Lack of specific guidance has resulted in services' not offsetting or reporting certain costs. For example, while the guidance requires reported costs to be adjusted for offsets, such as training not conducted, it does not specify that services' offsets should include the value of items that have been purchased for contingency operations but not used. U.S. Army, Europe and the 101st Airborne Division did not adjust their reported costs to reflect the value of supplies that were unused in the contingency.

DOD's February 1995 guidance also is not specific about reporting costs for training conducted to prepare for a contingency. As a result, the Army did not report these costs. In fiscal year 1994, aviation elements from the XVIII Airborne Corps incurred almost \$1 million in training costs for Haiti that were not included in the Army's contingency cost report. Also in fiscal year 1994, U.S. Army, Europe officials stated that they did not report predeployment training costs incurred for one division to prepare for Operation Able Sentry in Macedonia. Nonetheless, the Army is now tracking and reporting predeployment training costs associated with the preparation for operations in the former Yugoslavia.

**Guidance Is Not Clear on
How to Calculate Certain
Costs**

The DOD guidance does not specify how the services should calculate incremental personnel costs. It only provides examples of allowable categories of personnel costs such as family separation allowance and imminent danger pay. Consequently, the services calculate their incremental personnel cost differently. The Navy does not include all the special pays and allowances, the Air Force uses actual numbers of deployed personnel to estimate these costs, and the Army and the Marine Corps use an estimate of the number of persons deployed.

In some cases, commands within the services also calculate some costs differently. For example, the Navy's Atlantic and Pacific fleets used different methods to calculate flying hour costs. According to Navy officials, the Atlantic Fleet computed its incremental flying hour costs by determining its incremental hours and multiplying them by budgeted cost factors, while the Pacific Fleet used mostly actual costs. This is because Pacific Fleet officials believe that the difference between actual and budgeted cost factors allows them to fund unforeseen maintenance costs that do not appear until later fiscal years due to increased flying hours in support of contingency operations. Again, using different methods results in inconsistent cost reporting.

Guidance Is Not Clear on
How to Apply Internal
Control Standards

According to our Standards for Internal Controls, there are standards that are essential for providing the greatest assurance that the objective of accurate reporting will be achieved. These include maintaining supporting documentation, properly recording and classifying costs, and having adequate supervision and review of cost reporting.

We found that these generally accepted internal control standards were not always followed. For example, Navy Pacific Fleet officials were unable to support about \$2 million of their reported \$48 million in incremental costs for Operation Southern Watch because supporting documentation was unavailable. Further, one U.S. Army, Europe division did not capture and report its predeployment training costs for Macedonia and Rwanda. It also recorded some supply costs to the wrong operation.

We also found that adequate rigor was not always applied in the review of reported incremental costs. For example, in fiscal year 1994, the Navy inappropriately reported an \$8 million reimbursable cost as an incremental cost. The Navy was reimbursed for this cost by the Army. The Army also reported this cost resulting in reported costs being duplicated since both the Army and the Navy reported the same cost.

Reporting Officials Not
Aware of Guidance

For costs to be reported accurately and in accordance with guidance, service officials involved in the cost reporting need to be aware of this guidance. However, during our visits we found that some officials involved in accounting for incremental cost reporting at the service, major command, and unit levels were unaware of the February 1995 DOD guidance on contingency cost reporting. This included officials at various U.S. Army, Europe subordinate units; the Navy Surface Forces, Pacific

Fleet; and the U.S. Marine Corps Headquarters and Commander in Chief, Marine Forces Atlantic.

Weaknesses Exist in DOD Accounting Systems Used to Provide Data

DOD's Financial Management Regulation notes that data from existing systems shall be used as applicable to determine contingency operation costs and that cost accounting systems will not be established solely to determine incremental costs. Consequently, DOD must develop its cost reports within its existing systems. However, problems exist with DOD's accounting systems and the reliability of its data. The systems do not provide a firm foundation for DOD's managers to use in determining incremental costs for contingency operations.

The problems we identified in contingency cost reporting stem, in part, from the long-standing and pervasive problems that plague DOD's accounting systems. DOD's 1994 and 1995 Federal Managers' Financial Integrity Act (FMFIA) Statements of Assurance admit long-standing weaknesses in DOD's financial accounting process and systems. Under the FMFIA and implementing OMB guidance, the Secretary of Defense is required to provide this annual Statement of Assurance to the President and the Congress on whether the Department's system of internal controls, taken as a whole, complies with the act's requirements. DOD's Statements of Assurance cite its financial accounting process and systems as a high-risk area. The Statements note that DOD's operating accounting systems are not always in compliance with generally accepted government accounting standards or with internal management control objectives. As a result, the quality of financial information is not always reliable, and financial management practices are sometimes inadequate. Additionally, compilation of accurate financial statements is impeded, in part, by the lack of reliable information. Some broad categories of systemic problems reported include inadequate financial property records, unreliable accounting and payroll information, inaccurate or incomplete cost accounting information, improper or incomplete accrual accounting, improper reporting of the results of financial operations, and lack of financial system integration.

DOD has made numerous efforts to improve its financial management activities. A significant action was the establishment of a single DOD finance and accounting organization, the Defense Finance and Accounting Service, in January 1991. Its mission is to implement standard accounting policies and procedures throughout DOD. In May 1994, DOD announced the consolidation of over 300 finance and accounting sites into 26 locations.

The Defense Finance and Accounting Service also has responsibility for consolidating service incremental cost reports for contingency operations.

DOD Accounting Systems Are High Risk and Do Not Support Auditable Statements

We stated in a November 1995 testimony that DOD does not yet have adequate financial management processes in place to produce the information it needs to support its decision-making process.¹ We further stated that no military service or major DOD component has been able to withstand the scrutiny of an independent financial statements audit, a requirement established by the Chief Financial Officers Act. DOD's financial systems are not integrated and do not provide reliable information. Our review of the Navy's financial reports, the Army Audit Agency's review of the Army's financial statements, and the Air Force Audit Agency's review of the Air Force's financial statements identified significant accounting and reporting problems resulting in unauditable financial statements and reports for fiscal year 1994.² As an example, control practices used in the Navy's financial operations were fundamentally deficient: accounts and records were not routinely reconciled; periodic physical inventories were not always conducted; undocumented adjustments were common; and the reasonableness of account balances, adjustments, and data presented in financial reports was not regularly reviewed. DOD has acknowledged that its financial management systems are antiquated and cannot be relied upon to provide DOD management and the Congress with accurate and reliable financial information for use in decision-making.

DOD's FMFIA Statements of Assurance also noted that financial data in DOD is inadequately maintained within current accounting systems. In turn, the financial information and statements do not always adequately assist the management functions of budget formulation, budget execution, and proprietary and financial reporting with a high degree of reliability and confidence. An important deficiency cited included the lack of flexibility of most finance and accounting systems to rapidly respond to changing customer bases, legislative changes, contingency operations, management initiatives, requirements from other government central agencies, and other changes. Accordingly, DOD systems are classified as high risk by fiscal year 1994 and 1995 Statements of Assurance and OMB. Our February 1995 High Risk report also cited DOD's serious and long-standing

¹Financial Management: Challenges Facing DOD in Meeting the Goals for the Chief Financial Officers Act (GAO/T-AIMD-96-1, Nov. 14, 1995).

²CFO Act Financial Audits: Immediate Attention Must Be Given to Preparing Reliable Financial Information on Navy Operations (GAO/AIMD-96-7, Mar. 27, 1996), Audit of the Army's Principal Financial Statements Fiscal Years 1994 and 1993 (HQ 95-451, 23 Mar. 1995), and Opinion on Fiscal Year 1994 Air Force Consolidated Financial Statements (AFAA Project 94053001, 1 Mar. 1995).

financial management problems as high risk especially vulnerable to waste, fraud, abuse, and mismanagement.³

DOD's Systems Report Total Obligations

Besides the unreliability of its basic accounting data, DOD does not have cost accounting systems that can reliably state what was actually expended in support of a contingency operation. Existing systems report what was obligated to be spent. Previous audits have shown that such obligations can differ significantly from actual disbursements,⁴ resulting in DOD's paying billions of dollars in the course of normal business without being able to validate payments. For example, vendors were paid \$29 billion that cannot be matched to supporting documentation to determine if payments were proper. Such errors can affect the accuracy of the reported contingency costs extracted from these systems. DOD IG and service audits have also cited material weaknesses that exist in accounting and related systems.⁵ For example, billing data was not always available, reliable, or accurate to determine the authenticity of claims.

Recommendations

To improve the accuracy of cost reporting, we recommend that the Secretary of Defense direct the DOD Comptroller to clarify existing guidance to specify what costs to include in contingency operations cost reporting. At a minimum the guidance should specify the methodology to (1) calculate these costs and (2) adjust costs to reflect offsets. We further recommend that the Secretary of Defense direct the service secretaries to develop comprehensive implementing instructions from the DOD Comptroller's guidance. This guidance should specify how the services would like reporting units to apply internal controls standards so that incremental costs are adequately supported, recorded, and reviewed.

Agency Comments and Our Evaluation

DOD generally concurred with a draft of this report as being a reasonable portrayal of the problems inherent in accounting and reporting for contingency operations. DOD agreed with our recommendations and stated

³High-Risk Series: An Overview (GAO/HR-95-1, Feb. 1995).

⁴Financial Management: Status of Defense Efforts to Correct Disbursement Problems (GAO/AIMD-95-7, Oct. 5, 1994) and Financial Management: Financial Control and System Weaknesses Continue to Waste DOD Resources and Undermine Operations (GAO/T-AIMD/NSIAD-94-154, Apr. 12, 1994).

⁵Management Data Used to Manage the U.S. Transportation Command and the Military Department Transportation Organizations (DOD IG Report No. 94-163, June 30, 1994) and Audit of Reimbursements for Humanitarian Aid Missions, 21st Theater Army Area Command, Kaiserslautern, Germany (Army Audit Agency Report NR-95-707, April 3, 1995).

Chapter 3
Guidance for Reporting Incremental Costs Is
Vague and Accounting Systems Are
Unreliable

that it will attempt to clarify existing guidance to specify which costs to include in the cost reports and to better explain methodologies to be used and offsets to be incorporated.

Regarding our finding that DOD's guidance is general and incomplete and excludes discussion of offsetting certain costs, DOD commented that chapter 23, volume 12, of the DOD Financial Management Regulation discusses the intent that reported costs be adjusted for offsets, and while the regulation does not list every example of when offsets should be taken, it provides several examples of such offsets. Further, DOD noted that its regulation is intended to impart general guidance for use by the components, not detailed instructions. Such instructions in DOD's view are best left to the components to formulate to meet their individual requirements and circumstances. DOD's Financial Management Regulation does require that reported costs be adjusted for offsets and it provides some examples of types of offsets. But, DOD's guidance is vague about what costs to include as contingency costs and what methodology to use in calculating these costs. In addition, the services have not issued comprehensive implementing instructions. We have clarified our discussion in the executive summary of this report to reflect our overall concern with DOD's existing guidance.

Comments From the Department of Defense



COMPTROLLER

UNDER SECRETARY OF DEFENSE
1100 DEFENSE PENTAGON
WASHINGTON, DC 20301-1100



APR 23 1996

Mr. Richard Davis
Director, National Security Analysis
National Security and International Affairs Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Davis:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report, "CONTINGENCY OPERATIONS: DoD's Reported Costs Contain Significant Inaccuracies," dated March 18, 1996, (GAO Code 701068), OSD Case 1114.

The DoD generally concurs with the GAO draft report as being a reasonable portrayal of the problems inherent in accounting and reporting for contingency operations. As recommended, the Department will attempt to clarify existing guidance to specify which costs to include in the cost reports and to better explain methodologies to be used and offsets to be incorporated. The enclosed comments are provided to clarify and correct discrepancies in the report that relate to the DoD.

The DoD appreciates the opportunity to comment on the GAO draft report.

Sincerely,

Alice C. Maroni
Principal Deputy Under Secretary
of Defense (Comptroller)

Enclosure

Recommended Corrections/Comments

PRINCIPAL FINDINGS

Now on p. 5.

Page 6: Under the section "Vague and Incomplete Guidance" it is stated that DoD's guidance is general and incomplete and that it "excludes discussion of offsetting certain costs that are not incurred as a result of contingency operations and other savings that occur during participation in such operations, such as supply turn-ins." In fact, Chapter 23, Volume 12 of the DoD Financial Management Regulation does discuss such offsets on page 23-6, Section 2307: Determining Costs, paragraph C: Cost offsets which note that certain "costs for which funds have been appropriated may not be incurred as a result of a contingency operation." This is followed by several examples and the statement that "Reported incremental costs should be adjusted for cost offsets." While the example used in the GAO report of "supply turn-ins" is not specifically cited, it was not the intent of the chapter to try and provide an exhaustive list as this is impossible to do. Furthermore, as pointed out to GAO during the several meetings held on contingency operations, Chapter 23 of the Financial Management Regulation is intended to impart general guidance for use by the Components, not detailed instructions. Such instructions are best left to the Components to formulate to meet their individual requirements and circumstances, as required.

RECOMMENDATIONS

Now on p. 32.

Page 42: The two recommendations should eliminate reference to the "Secretary of Defense" and be reworded to indicate the "Under Secretary of Defense (Comptroller)", as the Chief Financial Officer within the Department, should clarify existing guidance to specify what costs to include in contingency operations cost reporting and to also direct the Components to develop comprehensive implementing instructions.

Major Contributors to This Report

National Security and
International Affairs
Division, Washington,
D.C.

Steven H. Sternlieb, Assistant Director
Lisa M. Quinn, Evaluator
Joanne L. Jurmu, Evaluator

Accounting and
Information
Management Division,
Washington, D.C.

Roger R. Stoltz, Assistant Director

Norfolk Field Office

Lindsay B. Harwood, Senior Evaluator
Joseph A. Rutecki, Senior Evaluator
Tracy W. Banks, Evaluator
Carleen C. Bennett, Evaluator
Willie J. Cheely, Jr., Evaluator
J. Larry Peacock, Evaluator
Suzanne K. Wren, Evaluator